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Cost and Management

The official journal of
The Society of Industrial
and Cost Accountants
of Canada

December, 1949

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COST *and* MANAGEMENT

VOL. XXIII

DECEMBER

NO. 11

NEW CONCEPTS OF INVENTORY PRICING

By Maurice H. Stans, C.P.A. 360

Mr. Stens is a Certified Public Accountant of Illinois, New York, Ohio and Wisconsin. He is a Director of James Talcott, Inc., New York City and a number of other business corporations. He is also a founder, President and Director of the Stans Foundations. He is the author of a number of articles on the subjects of Accounting, Auditing, Insurance, Small Business and Labor Management Relations. Mr. Stans is an authority on Inventory Control and Evaluation.

WILLS AND ESTATE PLANNING

By D. L. Evans 371

Mr. Evans is Assistant Manager of the Winnipeg Branch of the Royal Trust Company. Mr. Evans was born and educated in England. After serving in the first world war with the Canadian Forces, he joined the staff of the Royal Trust Company in 1919. He has given a great deal of his time to public campaigns and is president-elect of the Winnipeg Kiwanis Club.

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SOCIETY NOTES

A Message from Our President

SEEING EYES ARE INDISPENSABLE

To the men and women who have lost their eyesight, Seeing Eyes are indispensable. Without them, a segment of our population would not live a normal life. The many months of training of what is now known as the "Seeing Eye" have been repaid a thousandfold in terms of gainful employment and ability to move about out-of-doors as well as indoors.

What about "Seeing Eyes" in business?

It is commonly accepted that the Industrial Accountant and the Cost Executive are now an integral part of our Canadian Business Economy. Management depends upon them for advice and guidance in the manufacture or distribution of goods. The qualifications which they most possess, such as knowledge, practical experience and imagination enable them to push back old horizons, break new trails and often be pioneers in the conception of new ideas and in the application of new methods of control. With this assistance, Management is enabled to forecast wisely, prepare accurate budgets and reconcile actual production costs with budgeted figures.

Thus, the qualified Industrial Accountant or experienced Cost Executive can be referred to as "Seeing Eyes" in industry. This special training makes them eminently suitable for the task of control and supervision.

Seeing eyes are indispensable.

CHARLES P. DUMAS

ACCOUNTING EDUCATION IN THE OFFICE

It is the thought of many senior accountants, that their responsibility to students on their staff, is confined solely to instruction and direction in so far as they relate to company accounting procedure. Beyond that, all form of instruction and guidance should be derived from the course of studies being taken by the student. Such mistaken assumption is not only depriving the student of an important part of his training, but it also defers unduly the day when that student can assume more

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responsibility and be of greater value to his company. The practical experience which the student receives is of importance equal to the knowledge which he is acquiring through his course of studies, providing he has the sympathetic understanding of his supervisor from whom he is receiving his direction.

This requires something of a personal interest in the student—how far has he progressed with his course, how long has it taken him to reach that point, what are his intentions for the future? Does his added knowledge and ability qualify him for more responsible tasks? If he is not making satisfactory progress, what are the reasons. A few discreet inquiries at periodical intervals will very often save a student from bogging down, and avoiding the loss of that latent ability to the company. It may be found that the student's knowledge and ability qualify him for more responsible duties, or at least a change in his assignments. In large companies it is very desirable to rotate the work of junior accountants to familiarize them with the different phases of the accounting procedure.

But more important than this is the great need for development of the personality of the student. A good accountant is essentially an individualist, a man who has a positive personality and who can think and speak for himself. The great tragedy in many professions, and this is unmistakably true in accounting is the fact that a wealth of technical knowledge is negated by a weak personality. Gathering together factual data which is absolutely accurate and presenting it in logical form is only one stage in the work of a good accountant.

Exercising good judgment in the use of that information determines its true value. Supervisors will contribute immeasurably to the education and training of students, by providing them the opportunity to express themselves, by allowing them to assume some measure of responsibility as circumstances make it possible, and by encouraging them to exercise their own judgment. Knowledge is of little value unless it is synchronized with good judgment. If we can train our students in sound judgment, we are paving the way for sound management in business.

COST AND MANAGEMENT

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NON-RESIDENT, B.C. SOCIETY

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Chapter Notes

FORT WILLIAM-PORT ARTHUR CHAPTER

The regular November meeting was held at the Royal Edward Hotel, Fort William. An interesting and instructive address on the subject of "Basic Cost Accounting" was given by Mr. R. F. Manuel, Vice-President of the Toronto office of Stevenson-Kellogg Ltd.—well-known Management Engineers. Chairman C. D. Henderson presided and a vote of thanks to the speaker was moved on behalf of the Chapter by F. E. Wood, R.I.A.

VANCOUVER CHAPTER

The Chapter held their monthly meeting on November 10th, at the Hotel Georgia, Vancouver. The guest speaker was Mr. Norman O. Paquette, of Stevenson-Kellogg Ltd. Mr. C. H. Davis, R.I.A., introduced the speaker who delivered an interesting talk on "Basic Cost Accounting".

WINDSOR CHAPTER

The November meeting was held on November 17th, at the Norton-Palmer Hotel. Frank Bear was Chairman of the meeting. The speaker for the evening was Mr. W. G. McCarty, of the Manufacturers' National Bank of Detroit. Mr. McCarty gave an interesting address on the subject "Human Relations". The speaker was introduced by George Morgan, and the thanks of the meeting were given by D. W. McLean.

REGINA-MOOSE JAW CHAPTER

The regular meeting of the Chapter was held at Regina College on October 27th, with R. A. Kennedy presiding. The guest speaker for the evening was Mr. Lloyd Slater, of Highway Refineries, Regina, who gave an interesting talk on oil developments in western Canada and oil refinery costs. A vote of thanks was moved by W. Read and was heartily endorsed by the members.

LONDON CHAPTER

The regular September meeting of the Chapter was addressed by Mr. Earl Clubb on the subject of "Foreign Exchange Control". In October a joint meeting of the C.A.'s, C.P.A.'s, N.O.M.A. and the Society had as

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their guest speaker Dr. Chester Walters, Deputy Minister of Finance for Ontario.

NIAGARA CHAPTER

The November meeting was held on November 17th at the Hotel Barclay, Welland. After the dinner the members were conducted on a tour through the Stokes Rubber Company Plant. After the tour an interesting and comprehensive talk on the history of rubber and the development functions which are necessary for its origin in the plantations of Malaya and Ceylon. The meeting was presided over by D. Jones. Mr. Skidmore, of the Society and also Office Manager of Stokes Rubber, arranged the evening.

OTTAWA CHAPTER

The November meeting was held at the Alexander Hotel, Ottawa. The guest speaker was Ivan Manley, contract Administrator of Canadair Ltd., Montreal, who gave an interesting address on aviation production and Cost Control. Mr. H. R. Nurrish, of the R. L. Crain Ltd., was presented with an album of records as a gesture of appreciation from the Chapter. Mr. Nurrish was guest speaker at the provincial convention held in Ottawa last year.

HAMILTON CHAPTER

The regular monthly meeting was held at the Royal Connaught Hotel, on Thursday evening, November 17th, 1949. The best gathering of the year was augmented by the presence of a large number of members of the Toronto Chapter, making their annual visit to Hamilton.

The guest speaker of the evening, Mr. R. A. Read, of Messrs. J. D. Woods & Gordon, Ltd., Toronto, used as his subject "Breakeven Points". The audience was supplied with charts and other data by the speaker, who then proceeded to outline a method used to arrive at the breakeven point of a mythical company. After determining this point on the charts supplied, Mr. Read mentioned a number of situations that would tend to raise or lower the breakeven point and the steps necessary for management to take in order to maintain the profit rates.

Another feature of the evening was the presentation by Mr. J. B. Tennant, President of the Ontario Society, of a gold medal to E. W. Scott, Toronto, and a silver medal to G. L. Innes, Oshawa, for highest standings in Advanced Cost Accounting Examination. Also a silver medal to G. Hobbs, Windsor, for highest standing in Industrial Legislation exams which were held last spring. Mr. Tennant also presented R.I.A. certificates to the following student members who have successfully completed the S.I.C.A. Course:—L. W. Robertson, Hamilton, and Messrs. R. Bertrand, E. W. Scott, W. C. Matthews, C. J. Dutton and C. W. Ray, all of Toronto.

CONGRATULATIONS

Congratulations to R. J. Menary, R.I.A., former Chairman of the Hamilton Chapter, on his appointment as Commissioner of Finance of the Corp. of the City of Hamilton.

Current Literature Digest

By W. W. HENDERSON, R.I.A.

SIMPLIFYING MANAGEMENT REPORTS, by W. A. Neumann, Jr., The Controller, October, 1949.

The author sponsors the idea that financial reports for top management should be informative but concise. His article is a worthy reflection of his credo in that it tells much in a small compass of space.

He particularly stresses that chief accounting officers should portray the state of business in terms that will be well understood by non-accounting executives. "They are in that position," he says, "because of their ability to evaluate facts and plan a future. They should, therefore, be given those facts in the simplest, most usable, and most comprehensive form which can be prepared."

Statements, in his view, "had to provide a basis for orderly thinking and constructive analysis, which meant, in part, the elimination of bulk and confusion of papers and the use of color, wherever possible, to distinguish debit from credit figures and profits from losses."

Mr. Neumann suggests the use of the hectograph in issuing monthly financial statements. These statements, as he has prepared them, provide comparative monthly information. And in using the hectograph, he can fill in the current month column on the "master sheet", which while used before and containing information relative to previous months, is capable of producing further copies, and is not particularly subject to deterioration from the passage of time. Much repetitive effort is eliminated this way; yet not only the current month's results are portrayed, but at little cost in effort, those of previous months also show.

The Balance Sheet and Statement of Income exhibited in his article are stripped to the barest of condensed description and figures. Yet supplementary schedules are formally provided or made available for more detailed information. Examples of such schedules mentioned by Mr. Neumann are:—

1. Cost of Sales Schedule.
2. Schedule of Sales, General and Administrative expense.
3. Schedule of Inventories.
4. Schedule of Fixed Assets.

The author suggests that ratios should not be intermingled with dollar amounts to which they may pertain. Instead, record them elsewhere on the statement or separately. Figures are recorded to the closest \$1,000.00 (this it is suggested may not be universally practicable).

Mr. Neumann's specimen financial statements contain a comparison of 6 months only—January to June; July to December. Only 2 such statements a year need be retained, — June and December. Each of these contain information pertaining to the previous 5 months.

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APPLICATION OF STANDARD COSTS TO TEXTILE FINISHING OPERATIONS, by George C. Lyon. N.A.C.A. Bulletin — Volume XXXI, number 2, October, 1949.

Mr. Lyon explains the normal difficulties attending the application of standard cost procedures to the finishing processes in a textile factory. His suggested means of coping with these difficulties are cogent and comprehensive. Specimen exhibits make it possible to follow his explanations easily.

Overhead is segregated according to whether it is general or applicable on a process basis. General (i.e., indirect) overhead is applied on the basis of a general cost center burden rate, whereas direct overhead is applied to articles of manufacture on a process, or sub-center, burden rate. This permits more accurate costing and more informative variance segregations.

Indirect material, while possible of application on a burden rate basis, is by preference applied on a standard cost basis—i.e., according to specifications for manufacture. While nominally termed "indirect" the cost accounting treatment of such material is wholly analogous to that of direct material.

Burden—both indirect and direct—is applied on a standard direct labor hour basis.

Direct material is not specifically mentioned, but the standard cost of each finishing process is itemized, and such cost could be added to that attending articles at the time of reaching the finishing department. A complete standard cost is thereby obtainable.

Budgets are broken into fixed and variable sections.

Direct labor is applied on a standard basis, and such standards are predicated on time studies insofar as "duration of operation" is concerned.

CAPACITY CAN BE DECEPTIVE, by John Frederic Lohman. *The Controller*, October, 1949. (Part 1 of a 2 part article.)

This article stresses the fact that neither quantitative census of past volume, addition of total machine or man hours available, nor the standard units produced within those hours are reliable as control measures of either economic capacity or economic productivity.

The author says that it is not so much a matter of how great a quantity of goods can be produced, as it is basically a matter of how great a quantity need be produced in quality at the most reasonable cost.

This reader reads into Mr. Lohman's article the idea that plant capacity is a variable which moves according to no set pattern, and which requires careful analysis in order to be appraised correctly. Its effect on unit costs can be appreciable. The general idea that increased production invariably results in lower unit costs is qualified—usually yes, but on occasion the reverse can happen. Fixed overhead absorbed per unit will be reduced; but usage beyond a machine's effective capacity can frequently result in unit variable expense (such as maintenance) increasing in amount beyond its corresponding fixed expense reduction. The implication is that differential cost studies on a machine basis should be made at varying levels of load. The result of such analysis would be that uneconomical machines would usually be taken out of production or replaced.

Some equipment may be economical to a certain activity point—

CURRENT LITERATURE DIGEST

beyond that, unit costs mount to a place wherein, considering possible selling prices, too little or no profit remains. Costs to consumers during the war years and for some time afterwards were of secondary importance. To-day the picture has altered—the seller's market is disappearing fast.

The Cost Accountant will no doubt read this article with extreme interest, because burden variances are troublesome to apportion back to unit costs; and irrespective of the fact that unit costs do not in themselves set selling prices, their effect is paramount to the manufacturer, in his decision to eliminate lines, alter specifications, or to "carry on". Variances show up in Profit and Loss statements, so they are not overlooked; but the point of real control is the unit cost. Therefore, the closer its computation lies to accurate facts, the happier and more efficient will be the Cost Accountant. This article will in this light be of real value to him.

OTHER ARTICLES OF INTEREST TO INDUSTRIAL AND COST ACCOUNTANTS

Inter-Relationship of Variations from Budget and From Standard Cost,
by Othel D. Westfall—The Controller, Oct. 1949.

Capacity Can Be Deceptive,
by John Frederic Lohman—The Controller, Oct. 1949.

Production Planning and Inventory Control for Market Maintenance and Penetration,
by Dan. H. Barr—N.A.C.A. Bulletin, Oct. 1949.

An Outline of a Product Development Budgetary Control Procedure,
by J. C. Freeman—N.A.C.A. Bulletin, Oct. 1949.

The Philosophy of Conversion Cost Pricing,
by Fred L. Heath—N.A.C.A. Bulletin, Oct. 1949.

Depreciation and the Maintenance of Capital,
by John N. Myer—The New York C.P.A., Oct. 1949.

Cost Control,
by F. Clive de Paula—The Cost Accountant, Oct. 1949.

Accountants' Responsibility in Punched-Card System Installations,
by Leon E. Vannois, C.P.A.—The Journal of Accountancy.

Job Shop Production Control with Less Paperwork,
by Sidney C. Lumbard—Factory Management and Maintenance,
Oct. 1949.

ADDRESSES OF PUBLICATIONS

The Controller, 1 East 42nd St., New York 17, N.Y.

N.A.C.A. Bulletin, 505 Park Avenue (fourth floor), New York 22, N.Y.

The New York C.P.A., 667 Fifth Ave., New York 22, N.Y.

The Cost Accountant, 63 Portland Place, London W.1, England.

The Journal of Accountancy, 270 Madison Ave., New York 16, N.Y.

Factory Management and Maintenance, 330 West 42nd St., New York 18, N.Y.

New Concepts of Inventory Pricing

By MAURICE H. STANS, C.P.A.

This article is a critical analysis of two important bulletins issued in 1947 by the Committee on Accounting Procedure of the American Institute of Accountants. The statements contained in the bulletins and Mr. Stans' comments thereon relate specifically to accounting practice in United States, but the principles also apply in Canada. It is pointed out, however, that for income tax purposes, "Lifo" is not recognized as a basis for inventory valuation. Section 14, ss 2, of the Income Tax Act reads: "For the purpose of computing income the property described in an inventory shall be valued at its cost to the tax payer or its fair market value whichever is lower or in such other manner as may be permitted by regulations." At the time of going to press, no regulations had been issued under this section.

Business concerns, large and small, have just passed another post-war year characterized by inflated prices, a high volume of business and in most cases, large profits. Nation-wide, inventories are at the highest volume in history. While part of the national increase in inventories is due to higher price levels, the physical quantity of goods held by manufacturers, distributors and dealers is also in most categories in record amounts.

Underneath the visible evidences of prosperity and profits that exist is nevertheless a universal feeling of insecurity about the future. Business executives are continually being told by economists that there is bound to be an important price reaction somewhere ahead, that the seriousness of that reaction will depend upon a great many incalculable factors inherent in the domestic and foreign situation, and that the timing is highly uncertain, but that inevitably commodity prices (and resultant product prices) are going to be lower. This thought, of course, suggests the likelihood of future inventory losses at some time, the extent of the losses and the ability of the individual business to bear them being dependent in great part upon the impact of many world-wide uncertainties.

The fear that is generated under these circumstances has brought about a renewal of interest in the problems of inventory pricing and in the allied subject of inventory reserves. Lurking in the background is not only the unwillingness of business managements to incur and pay income taxes at high rates on profits which might prove in retrospect to be quite temporary

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and partially offset by subsequent losses, but also the unwillingness to be accused, by social reformers or business critics, of making excessive profits, in view of the uncertainty of being able to retain them at all.

On the other hand, such emphasis on present economic conditions is somewhat deceptive, because it implies that accounting principles and considerations may be different in times such as this than at other points of the business cycle. That is, of course, not true. The basic concepts of inventory pricing cannot be different at an upward point of a cycle than at a downward point. But it is true that economic events do exert their pressures on accounting practices, especially in the sense that times of change do create many difficult practical problems of inventory pricing.

It is no exaggeration to say that accountants have been wrestling with the subject of inventory pricing ever since the dawn of accounting—at least, ever since the realization that there could be no true measurement of business profits for an entrepreneur with a stock of goods unless he took into account some evaluation of that stock of goods. No exact method of inventory pricing has ever been successfully devised for all situations and none probably ever will¹.

NEED FOR PRINCIPLES

It is clear then that the approach to inventory pricing must be in the light of the practical purpose for which inventories

¹As a matter of fact, there are only three recorded instances in history and literature in which the secret of absolute or exact valuation of a stock of goods has been asserted, and these are all outside the realm of accounting as we know it. Thomas Paine, in his "Crisis", put it in a supernatural way:

"Heaven knows how to put a proper price upon its goods," but practising accountants are not in a position to obtain this formula in time to make it useful. Then the great Emerson in one of his essays implied that valuation is at least superhuman:

"In nature there is no false valuations."

Finally, it is reported that, centuries ago when the designing Cleopatra gave Anthony an inventory of her assets, she said:

"This is the brief of money, plate, and jewels I am possess'd of: 'tis exactly valued."

Shakespeare unfortunately did not disclose, by footnote or otherwise, whether Cleopatra used "lifo" or "fifo" in her calculations, or whether she observed the "lower of cost or market" rule and of course, there was then no Securities and Exchange Commission to impose this obligation upon him, so that the secret is lost.

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enter into business accounting. That purpose is, of course, the development of useful financial reports, and in particular the faithful presentation of the report of business progress known as the income statement. It is readily understandable that there can be but doubtful usefulness in any sequence of financial reports of a company that employs varying methods of inventory pricing from one period to another. There is little honest usefulness in financial reports that show a trail of inventory reserves running through the accounts in confusing charges and credits, so that no one but an expert or an insider can tell what the true business results are. There is limited usefulness in an income report which cannot be compared with a competitor because each company uses different methods of inventory pricing, or because one creates reserves and the other does not, or because the reserves charged against income by both companies are creations of management without any uniform standard of measurement. The company that is small may be able to ignore for a time the fact that the public — the investor, the consumer, the laborer, the taxpayer—is becoming greatly more conscious of income accounting. The company that is large knows that, as a matter of public relations alone, the time for increasing objectivity is already growing late, because it can be proved that business income reports are by and large greatly misunderstood and greatly distrusted.

Because of the methods by which accounting procedures have historically developed, and especially the fact that most of the refinements of accounting are recent developments of the competitive phases of the industrial revolution, it is not surprising that substantial areas of differences have grown up. When these differences have been sufficient to prevent comparisons between companies or lead to confusion in the interpretation in the reports of individual companies, it is not surprising either that there should develop severe criticism of published financial information and much suspicion of corporate financial statements.² In recent years these differences have provided a basis for attacks on business by those whose purposes are more devious. Nine years ago the American Institute

²A recent public opinion survey conducted by Controllership Foundation, Inc. brought to light the startling impressions, among others, that forty-five percent of the public believes that reported profits of corporations are deliberately understated, and that fifty-nine percent of the public

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of Accountants, the national organization of practising certified public accountants, undertook a major program directed toward the reduction of these differences. It created a major committee, called the committee on accounting procedure, to examine controversial questions in accounting and to recommend procedures to be followed, in the hope that the areas of differences would be reduced and published financial statements would thereby be made more useful. To date this committee has issued 36 bulletins, each of which has dealt with some problem that had proved troublesome or confusing. These statements carry only the weight of their own reasoning and the reputation of the members of the committee, but they appear to have made important gains in the direction of narrowing some of the variations in accounting procedures of the past. In the last year the committee has released two very important bulletins on the subject of inventory pricing. Bulletin 29 is entitled "Inventory Pricing" and Bulletin 31 is entitled "Inventory Reserves". They contain the first comprehensive, authoritative expressions of the accounting profession on these subjects.

BULLETIN NO. 29—INVENTORY PRICING

In the course of its development of this bulletin, the committee on accounting procedure made several surveys of inventory pricing practices. The number of divergencies in methods was almost legion. In fairness, it should be conceded that the variations in application were not much more extensive than the area of theoretical differences which had grown up among accounting writers through the years. The differences in pricing ranged from companies that excluded all manufacturing burden as an inventory cost (or excluded fixed charges from manufacturing burden, to those that included some or all of administrative and selling expenses as an inventory cost, or valued inventories at selling price. When copies of early drafts of the bulletin were submitted to organizations such as the National Association of Cost Accountants, the Controllers Institute, the state societies of certified public accountants and to

believe that it is difficult to understand a typical profit and loss statement. The survey report clearly showed that beliefs such as these lead to the further prevalent belief that business makes an exorbitant amount of profit.

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accounting officers of representative manufacturing companies, the opinions were equally divergent. The final resulting bulletin contains some compromises of viewpoint and is clearly a single and perhaps very temporary step in the evolution of inventory pricing practices. Its worthiness lies in the fact that it authoritatively expresses the basic objective of inventory pricing, rules out some of the more extreme pricing practices, and effectively narrows the area of theoretical difference while at the same time permitting considerable latitude within the premise of objectivity in the determination of income.

The bulletin contains 10 basic propositions with an explanation of each. The first proposition, beyond defining the term "inventory", merely states that accounting for inventories is necessary for any business whose operation involves a stock of goods. The other statements are as follows:

Statement 2 affirms that the major objective in accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues.

Statement 3 adopts "cost" as the primary basis of accounting for inventories, and defines generally the meaning of the term.

Statement 4 approves the use of any one of several assumptions as to the flow of cost factors (such as "first-in, first-out", "average", and "last-in, first-out") but emphasizes that the method selected should be the one which, under the circumstances, most clearly reflects periodic income.

Statement 5 requires a departure from the cost basis of pricing an inventory when the usefulness of the goods is no longer as great as its cost, whether due to physical deterioration, obsolescence, change in price levels or other causes. It adopts the term "market" for the lower valuation to be applied and requires the difference to be recognized as a current loss.

Statement 6 defines the term "market" as used in the phrase "lower of cost or market", as being current replacement cost (by purchase or by reproduction, as the case may be), but makes certain exceptions to this definition.

Statement 7 approves the application of the rule of "cost or market whichever is lower", either directly to each item in the inventory or to the total of the inventory or to the total of each major category, depending upon which most clearly reflects periodic income.

Statement 8 calls for consistency in pricing methods and a disclosure in the financial statements of the methods used

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as well as a disclosure of the effect of any change in methods.

Statement 9 rules out the pricing of inventories above cost except in extreme cases such as those of precious metals having a fixed monetary value.

Statement 10 requires that accrued losses on firm, uncancelable and unprotected purchase commitments should be recognized in the accounts in the same way as are inventory losses.

Some of these points are worth close review. Statement 3, which adopts "cost" as the primary basis of accounting, defines cost, as applied to inventories, as being "the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location." It admits that this is not always easy to determine but it does lay down some special considerations. For example, under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges rather than as a portion of the inventory cost. Also, except for the portion of general and administrative expenses that may be clearly related to production, it is generally accepted accounting practice to include such items as period charges and to exclude them from inventory costs (product charges). Selling expenses constitute no part of inventory costs. The exclusion of all overheads from inventory costs does not constitute an accepted accounting procedure.

Statement 4, which permits the use of either "fifo", "lifo", "average", or "base stock" assumptions as to the flow of cost factors, suggests that the choice be made with due regard to the nature of the business. It says: "these methods recognize the variations which exist in the relationships of costs to sales prices under different economic conditions. Thus, where sales prices are promptly influenced by changes in reproductive costs, an assumption of the 'last-in, first-out' flow of cost factors may be the more appropriate. Where no such cost-price relationship exists, the 'first-in, first-out' or an 'average' method may be more properly utilized." It also approves the reversed mark-up procedure of inventory pricing usually known as the retail inventory method. It states that standard costs are acceptable but only if they are adjusted at reasonable intervals to reflect current conditions.

The manner in which the term "market" is defined for

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inventory pricing purposes is extremely interesting. In fixing "cost" as the primary basis and then stating that a downward departure from cost is required when the usefulness of the goods is no longer as great as its cost, whether due to physical condition or to change in price levels, the bulletin adopts a concept which has been described by some accountants as "useful cost", which adopts as a measure of pricing the idea of "cost or useful cost, whichever is lower." Because of its long standing practice, the expression "cost or market, whichever is lower" is considered to be being synonymous and is adopted as the means of expression of this concept. Market, therefore, is not an appraisal of the value of the goods against any single price index or factor. It is an attempt to recognize that portion of an expenditure which has retained value, but only to the extent that it has retained value.

How does the bulletin propose to measure this utility? The answer is in Statement 6 which is repeated verbatim:

As used in the phrase "lower of cost or market", the term "market" means current replacement cost (by purchase or by reproduction, as the case may be) except that:

(1) Market *should not exceed* the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal) and

(2) Market *should not be less than* net realizable value reduced by an allowance for an approximately normal profit margin.

This statement recognizes the fact that as a general guide the usefulness of goods is indicated primarily by what it would cost currently to replace them, either by purchase or by reproduction, but there are two necessary exceptions to such a standard. Replacement or reproduction price would not be appropriate when the estimated sales value, reduced by the costs of completion and disposal, is less; in such case, that realizable value measures utility. On the other hand, when the evidence indicates that cost will be recovered with an approximately normal margin of profit upon sale in the ordinary course of business, no loss should be recognized even though replacement or reproduction costs are lower. This might be true, for example, in the case of production under firm sales contracts at fixed prices, or when a reasonable volume of future orders is assured at stable selling prices. The bulletin, therefore, disapproves of

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writing down an inventory merely to create a greater profit in a future period. It specifically recognizes that if a business is expected to lose money for a sustained period, the inventory should not be written down to offset a loss inherent in the subsequent operations.

The application of this concept of the "lower of cost or market" rule is illustrated in the accompanying over-simplified table. Of course, there are not more than a few situations in which the measurement of the factors involved will be as readily evident as is assumed in these illustrations. However, the cases cited do give a clear exposition of the broad intent of the rule under the bulletin, and should therefore afford an interpretation of the general principle for application to practical pricing work.

One other statement in the bulletin represents an important deviation from past practice. It suggests that although the rule of "cost or market, whichever is lower" may be applied directly to each item in the inventory, in many circumstances periodic income will be more clearly reflected if the rule is applied to the total of the inventory or to the total of the components of each major category. The type of case which it attempts to reach is easily illustrated. If a manufacturer of refrigerators finds that the cost of the wood components is in excess of replacement whereas the cost of the steel components is less than replacement by an approximately equivalent amount, with no indicated change in selling price, it would be false accounting to write the wood components down to the lower replacement price while at the same time holding the steel components at cost. Such a practice would merely reduce profits in the current period for the benefit of the next period.

This bulletin clearly leaves much to be desired and is certain to please no one completely. Undoubtedly the permitted ranges of practice still need greater narrowing. The most important single statement in the bulletin is perhaps the suggestion that in time uniform methods of pricing be devised within each of the principal industries. There can certainly be no disadvantage in such a procedure (other than the arguments that spring from rugged individualism) and there can be many advantages, the principal one of which would be the use of a common denominator for the benefit of the readers of financial statements.

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In summary, the major accomplishments of the bulletin are these:

(a) The emphasis on the objective of proper income determination, rather than that of valuation for purposes of the balance sheet.

(b) The affirmation of the "cost or market" rule and the definition of that rule in terms of cost usefulness.

(c) The requirement of recording accrued losses on uncancelable and unprotected commitments.

If the bulletin accomplishes merely a minor gain in its purpose of proper measurement of income, with the resulting achievement of greater comparability of business results, it will have proved to be a major document.

BULLETIN 31—INVENTORY RESERVES

This bulletin deals with the subject of reserves for future inventory declines, which may be defined as reserves for losses which have not occurred at the date of the balance sheet and are not in prospect on the realization of the inventory then on hand. In effect, this bulletin holds that the principles of Bulletin 29 are all-inclusive and that an inventory which is priced at the lower of cost or market as therein defined cannot be further reduced, for purposes of computing income, by a reserve for future losses. The exact language of the bulletin in this respect is as follows:

"The committee is therefore of the opinion that inventory reserves, such as those created:

(a) for possible future inventory losses on inventories not on hand or contracted for, or

(b) without regard to any specific loss reasonably related to the operations of the current period, or

(c) for the purpose of reducing inventories other than to a basis which is in accordance with generally accepted accounting principles (Bulletin 29), are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income and that they should not be used to relieve the income account of any year."

While the bulletin is brief, its conclusions are the result of long deliberation and thorough consideration of alternative and contrary viewpoints by the committee. It is recognized that some business managements have an honest difference of opinion from this conclusion. However, considering the great need for more precise determinations of business income, it seems reasonable to believe that in time the committee's viewpoint will be clearly demonstrated to be sound.

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The argument against the bulletin and in favor of inventory reserves is simple.³ It is that all economic events have their reactions, that periods of rising prices create profits that will be offset by losses in periods of lowering prices, that future uncertainties should be met directly from the income realized during highly profitable periods, and (in some vague way) future losses should thus be charged against the profits from which they stem. This viewpoint was expressed by one of the dissenters to the bulletin in these words:

"Traditional accounting practices are clearly inadequate to cope with existing extraordinary price inflation and subsequent substantial deflation that appears inevitable based on past experience. Obviously reserve provisions made capriciously to equalize profits between years must be condemned. It seems equally plain, however, that accounting rules should not force business to report inventory profits as unqualifiedly realized in the face of conviction that such profits will never be realized. Neither should business be forced to adopt the involved last-in, first-out method as the only means of eliminating such profits. This extraordinary price situation requires sensible tolerance in making objective tests of business judgments exercised in good faith and a realistic consideration of substance rather than technical adherence to form."

The argument for the bulletin is not quite as easy to state, because it is more basic. It involves the direct question of the objectivity of income reporting, of the elimination of public distrust in accounting, and the even broader social responsibility of financial reports to tell a truthful and unconfusing story. The argument enters the area of the questionable validity of any type of reserve for something which has not happened in an accruable sense when it is applied against income for the purpose of producing a result different from that which actually occurred. Those who argue for inventory reserves, or for any other type of reserve to balance cyclic effects over a period of years, are arguing for artificial equalization of reported profits. They are confusing, honestly though it may be, the problems of business finance, of divided policy, of labor relations, and of all of the other involvements that spring from a showing of profit,

³The bulletin and this discussion are directed only at inventory reserves created by charges to current income. There is, of course, no objection to an inventory reserve created from surplus and returned in whole to surplus when no longer considered necessary.

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to justify artificial understatement of that profit. A good many years ago a committee of the American Institute of Accountants, in correspondence with the New York Stock Exchange, stated the objective of income accounting as being "the best reflection, reasonably obtainable, of the earning capacity of the business under the conditions existing during the year to which it relates." Clearly, the use of inventory reserves violates that concept by reaching into the future.

"There is a possibility of future loss in the inventory should prices decline. The amount of such loss, if any, will depend, of course, on future conditions. No reserve for this contingency has been specifically provided in the financial statement because it is the opinion of the Board of Directors that the present surplus account is more than adequate protection for this contingency."

To some this bulletin may not be easy to accept in the first instance. To them it is fair to make one concession. Perhaps basic business concepts of profits are at fault and rapidly rising or falling price levels do bring out the need for different ones. Perhaps we should in time develop a system of measuring business activity and business results in terms of index numbers. Perhaps we should abandon the idea of attempting to measure profit in a short fiscal period and should devise a system of income reporting on a basis of moving cycle periods. Possibly existing accounting procedures would be most effective for reporting if a plan for measuring profits in terms of constant units of value were developed and supplementary statements in terms of such a constant unit were adopted.

However, until some basic change in business measurement or some sound change in accounting procedure can be developed to meet these current difficulties, accountants must resist the adoption of procedures that have no basis for objective determination and no assurance of consistent application. Certainly the answer to this problem is not for each company to decide what its profits shall be, or what procedures shall be applied, without regard to the need for orderly and consistent practices. Business as a whole will suffer if there should be any widespread belief among users of financial statements that charges of income are based on the whim of management, are not in accordance with generally accepted accounting procedures, and cannot be tested for fairness within reasonable limits.

Wills and Estate Planning

By D. L. EVANS
Royal Trust Co., Winnipeg

The author outlines several basic principles which determine the amounts of the succession duties and how they shall be paid. If these principles are given proper consideration during the life of the testator, the best interests of his estate will be protected and the financial position of his business shall be preserved. Particular reference is made to the person owning a proprietorship business or contracting corporation.

Some wag has said: "The power of the Will is a wonderful thing; it makes both your children and your grandchildren behave themselves."

Why a Will? Instinctively, people wish to provide—so far as they can—for the material security of their dependents and for the division of their worldly goods after their death. Most people have at least some conception of how they would wish their property to be dealt with after their death, and the law of every civilized country recognizes their right to give effect to their wishes within certain limits. The privilege of making a Will is part of our democratic way of life—a privilege which should be exercised just as much as the right to vote. Notwithstanding this, a very large proportion of the people on this continent die without making a Will. There are two reasons for this. In the first place, as one of the ancients said: "No one is so old as to think he may not live a year." If it be winter, the average man of any age is sure he will carry on to see the robins return in the spring. In summer, he knows full well he is not destined to pass on until he has harvested this year's garden crop. The second reason why Will making is not popular is because there is a general impression that a Will is a luxury for the rich. It is accepted that Mr. Millions, when he dies, will leave his estate carefully guarded by a long, legal document; but the man who has nothing except a house, some life insurance, a few bonds, and a little money in the bank, assumes it is not enough to bother about. So he dies, and his wife who might—under a proper Will—have entered into an early enjoyment of his estate, finds herself involved in an immense amount of legal formality. A rich man's estate will stand it—a Will for him is more or less of a luxury. But it is a necessity for the man of smaller means.

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Wills have been known from the earliest periods of human history. It is claimed by learned antiquarians that Adam, Noah and Job made testamentary dispositions of their property. That the old patriarch, Jacob, did so cannot be doubted, for the Scripture records that Joseph received "a portion above his brethren." The Will, as we know it, is supposed to come from Roman Law: yet, many years before the Roman Empire, Wills in written form were known in Egypt—a part and parcel of their high state of civilization. A few years ago, there was unearthed in Egypt the earliest known written Will. It was executed in 2548 B.C. and yet is so curiously modern that it might be granted probate to-day. Men have been exhorted to make Wills almost from time immemorial. The Book of Common Prayer, as used by the Anglican Church in Canada and the Episcopal Church in the United States, contains a rubric exhorting men to make their Wills "whilst they are in health". Shakespeare, in Richard II, says "Let's choose executors and talk of Wills". Dickens, in a number of his works, deals quite extensively with the subject—particularly in "Bleak House".

Who may make a Will? Any person of sound mind, twenty-one years of age or over, can make a Will. There are several types of Will but the two most popular are the regular Will, which is a Will usually typewritten and signed by the testator in the presence of two witnesses, and the other is what is known as a "holograph" Will. That is a Will written entirely in the hand-writing of the testator and does not require the assistance or presence of witnesses. Holograph Wills, however, are not legal in all Provinces—and Ontario is one of them.

And now something on the subject of Succession Duty. For many years succession duties were levied by all the Provinces. In Ontario the first Succession Duty Act came into force on the 1st July, 1892, and has been frequently amended since. In 1941 the Dominion Government entered the field and passed its first Succession Duty Act effective on and from the 14th June of that year. In 1947 that Act was amended by exactly doubling the rates of duty. At the same time it was provided, in the amendment, that the Dominion Government would allow as a rebate the duty paid under any Provincial Succession Duty Act up to one half of the Dominion Duty. Arising out of the negotiations between the Dominion Government and the Provinces, as recommended by the Rowell-Sirois Report, seven of the then

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nine Provinces entered into an agreement to suspend their respective Acts in exchange for certain other benefits so that, in those seven Provinces, the Dominion Government is the sole collector of Succession Duty. The Province of Ontario was one of the Provinces which did not enter into the agreement with the central government (the other being Quebec) so that, in Ontario, both governments are still in the field.

Succession Duty may be defined as a tax imposed upon the transmission of any kind of property owing to death. Unlike income taxes, which must be considered each year, there is only one time when succession duties are levied—and that is at death. Accordingly, to postpone consideration of the subject to that time is to fail to consider it at all. The settlement and payment of Succession Duties has become one of the most exacting responsibilities of executorship and anyone planning his Will must give added thought to the amount of Duty that will be payable and to make provision for payment. Contrary to popular belief, Succession Duty is not a tax against an estate. Each heir or legatee (with certain exceptions) of the estate of a deceased person must pay Succession Duty on the value of his or her inheritance, having regard for the value of the inheritance, the value of the estate and the relationship of the beneficiary to the deceased. Most men, when this is brought to their attention, express the wish to have all succession duties paid out of the estate so that beneficiaries getting specific bequests or cash legacies will receive, in full, the object of his bounty. This can be arranged by appropriate wording in a properly planned Will. In case some of you may be wondering how much Succession Duty your heirs may be liable for, let me say that under the Dominion Succession Duty Act all estates of \$50,000., or less, are tax exempt. Under the Ontario Act all estates are exempt of \$50,000., or less, which pass to near relatives—that is, grandparents, parents, husband, wife, child, children-in-law or grandchildren. This does not, of course, mean that where an estate exceeds \$50,000. there is an exemption of \$50,000. There are three factors which determine the rate at which Succession Duty is levied—the size of the estate, the relationship of the beneficiary to the deceased and, perhaps, most important of all, the method of distribution. The same estate going to the same people in slightly different ways will be taxed at different rates. Take the case of the man with a

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wife and, say, two children both over 18 years of age. We will say he has an estate of \$75,000. Being a dutiful husband, he has made a Will and left his estate to his wife who has been such an encouragement to him and helped make him what he is. The combined Dominion and Province of Ontario Succession Duty, in that case, would amount to approximately \$6,700. The widow has now become the sole owner of her husband's estate but, being mortal, she too must die—which she does about five years after her husband. Under her Will, she leaves her estate in equal shares to the two children, but, once again, the Government demands its share (and, in Ontario, both Governments) and the combined amount paid this time is about \$7,100. You see, therefore, that in a short space of five years an estate of \$75,000. has been reduced by about \$14,000. through payment of Succession Duty—or by almost 20%. Suppose now that instead of the husband giving his estate to his wife he had only given her, outright, the family residence and contents and the family car valued at, say, \$11,000., and then provided that his wife should get the income from what was left during the remainder of her lifetime and that, on her death, the capital was to be divided between the two children. The Succession Duty, under those circumstances, would be reduced to about \$6,200. or by approximately \$7,700. less than was previously the case. Furthermore, of the \$6,200. payable, approximately \$3,000. could be paid in four equal annual instalments, without interest, instead of having to pay all the duty within six months as was the case when the whole estate was given outright.

The valuation of shares in small companies, where the stock is held in few hands, is frequently a matter of much concern to executors. It is not an unusual practice for a man operating his own business to "plow" back the profits after withdrawing sufficient each year for his living requirements. He tends to look upon his company as himself and feels it does not much matter whether the surplus is kept in the company or withdrawn and held by him personally. In either case, it is his. As a result of this accumulation of profits in the company, the owner may and probably has very few assets of his own, other than the stock he owns in the company. The problem which immediately confronts his executor is where and how to raise the money to pay Succession Duty. Particularly is this the case where the

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profits are invested in plant and equipment and, therefore, cannot be realized except, perhaps, by a sale of the company—possibly at a sacrifice price. But even though the profits may be in liquid form, the problem is still there. The only way the profits could be withdrawn would be by declaring a dividend. Such dividend would then be subject to personal income tax at high rates. As can be seen, this owner and his company are not the same entity. After death, I am afraid nothing much can be done with a situation such as I have outlined; but, in the proper planning of a Will, it would probably come to light and some relief might be found. For instance, the owner may increase his salary and put by the extra amount which he does not need for living expenses or he may declare dividends from time to time. In either case, such withdrawals would be subject to personal income tax but at rates much lower than would be the case where the accumulated profits are withdrawn in one lump sum after death. Not every business is incorporated. There are advantages to incorporation. There are also disadvantages. If the owner of the business of which we have been speaking had, in the first instance when incorporating his company, given some particular thought to the incidence of taxation, it might have been possible to set up his company in such a way as to make possible the withdrawal of the undistributed profits without incurring liability under the Income Tax Act.

Both the Province of Ontario and the Dominion Succession Duty Acts provide that assets shall be valued as at the date of death of the deceased. In the case of listed securities, the closing price on the date of death is taken as the value for Succession Duty purposes. In the case of unlisted securities, a value is determined after consideration has been given to the company balance sheets for a number of years. It can, I think, be readily understood that honest differences of opinion may arise between the Succession Duty Departments on the one hand and the executors on the other—and the knowledge and experience of the executor is sometimes a factor in determining a fair value.

There are certain provisions which, experience shows, should be contained in properly planned Wills. To illustrate: The business carried on by the testator cannot, usually, be continued by the executor without express authority (I am speaking now about proprietorships and not limited liability companies) and such relations as those between partners in busi-

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ness, or persons who have gone into a joint enterprise together, or those of principal and agent, are terminated by death; and the executor, without special power, is prevented from continuing those relations for the benefit of the estate, even though it may be most prudent to do so. Protection might be afforded the estate by the inclusion of a properly worded clause in the Will.

In the realization of stocks, bonds or other securities, whether absolutely owned by the testator or held by him on margin, a good deal depends upon the nature of the securities and the market in which they are chiefly dealt in—for their sudden disposal in a market not in condition to absorb them is sometimes of great disadvantage to the estate. At the same time, unless special power is conferred by the Will, it is probably the duty of the executor to sell such assets, as have to be sold, without regard to speculative considerations as to the possible improvement of the market. The advantage of the estate would be best conserved by conferring discretionary power upon the executor.

There are certain times when, from a strict legal point of view, it is difficult to decide what payments and receipts are to be treated as capital and what as revenue—and the executor should be given discretionary power to make the decision.

In the absence of specific power, an executor having funds to invest is limited to investments authorized by law, which, for all practical purposes, means bonds issued or guaranteed by the Dominion of Canada or the Provinces thereof. In these days of low income yields, it is not infrequently necessary for the well-being of the deceased's family to obtain a higher yield than can be obtained from that type of investment, and, in order to accomplish this, power should be given the executor—always assuming he has confidence in his executor, and he should not appoint him unless he has—to invest in such securities as seem safe without being limited to investments permitted to executors by law.

I have not said anything about Gifts. That is almost a study in itself. There may be cases where it would be advantageous for a man to give away part of his assets during his lifetime; but under the Ontario Succession Duty gifts to be tax free must be made 5 years before death. Under the Dominion Act the required period is 3 years.

« STUDENT SECTION »

GENERAL ACCOUNTING

Comments by J. D. CAMPBELL, C.A., R.I.A.

ACCOUNTING I, QUESTION 3 (20 marks)

- (a) Write a brief description of the purpose of and the advantages to be gained by the use of controlling accounts.
- (b) Write up controlling accounts for both the accounts receivable and accounts payable for the month of October last, using the following information concerning transactions of that month. Indicate the book of original entry from which each posting would, in practice, be made.
- (1) Balances of accounts due from trade debtors as of October 1, \$8,600.
 - (2) Balances of accounts due to trade creditors as of October 1, \$4,300.
 - (3) Sales to customers on credit, \$20,000.
 - (4) Purchases from creditors, \$18,500.
 - (5) Cash received from customers, \$16,600.
 - (6) Cash discounts granted, \$350.
 - (7) Creditors' time drafts accepted, \$2,400.
 - (8) Bills received from customers, \$1,600.
 - (9) Payments made to trade creditors (on open account), \$14,800.
 - (10) Cash discounts earned, \$210.
 - (11) Returns to and allowances from trade creditors, \$320.
 - (12) Returns from and allowances to trade debtors, \$950.
 - (13) Contra accounts transferred with respect to business firms who were both debtors and creditors, \$1,500.

Solution

(a) The primary purpose of the controlling account is that it facilitates the recording process in that it allows the principle of division of labour to be applied to the posting procedure.

Certain attendant advantages arise out of the use of the controlling account.

1. Facilitates the location of errors.
2. The division of labour leads to the creation of a degree of internal check which tends to discourage manipulation and fraud and provides for a basis of allocation of responsibility.
3. The elimination of a substantial amount of detail from the general ledger replaced by totals facilitates the preparation of the financial reports.

(b) Accounts Receivable Controlling Account

1948		Dr.	Cr.	Balance
Oct. 1	Balance			Dr. \$8,600
31	Sales	S.J. \$20,000		
31	Cash and discounts	C.R.	16,950	

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31	Bills receivable	B.R.	1,600	
31	Returns and allowances	R.S.J.	950	
31	Contra accounts	G.J.	1,500	Dr. 7,600

Accounts Payable Controlling Account

1948			Dr.	Cr.	Balance
Oct. 1	Balance				Cr. \$4,300
31	Purchases	P.J.		\$18,500	
31	Bills payable	B.P.J.	\$2,400		
31	Cash and discounts	C.D.	15,010		
31	Returns and allowances	R.P.J.	320		
31	Contra accounts	G.J.	1,500		Cr. 3,570

Comments:

The (a) division of the question was answered fair but in the majority of cases the student did not express his thoughts too clearly and the tendency was to indicate certain advantages in a sketchy manner which left one wondering if the student understood what he had indicated.

The following quotation taken from a student's answer paper illustrates the point.

"Controlling accounts are usually kept by large concerns in order that the general ledger keeper may post all necessary entries at month end rather than wait for the individual account keeper (accounts receivable clerk, accounts pay, clerks, etc.) to post his work in detail. A more concise but accurate record is kept by the control accounts thus making it much easier to handle when preparing Statement of Revenue and Expenditure, etc."

This particular section of the question might have been marked more stringently than it was but an attempt was made to give the student the benefit of the doubt.

The (b) section of the question brought forth the usual types of errors which one finds in a question of this nature with the failure to record cash discounts received and allowed topping the list. This might be attributed to the failure to read the question carefully as it definitely stated "Cash received from customers" and "Payments made to trade creditors" which items do not include the item of discounts. It is more likely due to a misunderstanding as to the nature of cash discounts believing it to be a cash transaction when it is not. The item of contra accounts caused a great deal of trouble and in a number of instances were disregarded or treated just opposite to that indicated in the question. In certain instances the terms trade debtors and trade creditors were misinterpreted.

In one instance a synoptic journal was presented with the entries presented recorded as debits and credits. Although certain credit was allowed for the answer it indicated that the student did not read the question carefully or did not understand the requirements.

ADVANCED COST ACCOUNTING

QUESTION III

QUESTION 3 (13 marks)

In the Manufacturing Company X Y Limited.

Two products A and B are considered as joint products and a third one, C as a by-product.

STUDENT SECTION

Selling price of product A, \$1.50; of B, \$3.00 and of C, \$0.50 per unit.

Manufacturing expenses absorbed directly by A, \$8,000; by B, \$16,500, and by C, \$600.00.

Manufacturing expenses (additional to those aforementioned) at the time of separation, \$15,900.

Total Selling Expenses, \$3,720.

Gross Sales A, \$12,000; of B, \$24,000, and of C, \$1,200.

At the beginning of the period the Inventories were valued at:

A, \$6,500; B, \$9,500.

At the end of the same period the Inventories were valued at:

A, \$8,500; B, \$6,500.

It is the practice of the company to deduct the net revenue from the sales of C, from the cost of A and B at the time of separation.

Note: Net revenue equals Gross Revenue from sale less selling expenses allocated to C and manufacturing expenses absorbed directly by C.

Selling expenses are distributed to A, B and C according to the gross sales of each.

Manufacturing expenses at the time of separation of A, B and C are distributed to A and B on the basis of the selling price of these products.

Required:

From the foregoing data, prepare a Profit and Loss Statement by Products for the Company X Y Limited.

SOLUTION TO QUESTION 3

The Manufacturing Company X Y Limited Statement of Profit and Loss by Products for the period ended

	A	B	Total
Sales	12,000	24,000	36,000
Less Cost of Sales:			
Inventory at beginning	6,500	9,500	16,000
Manufacturing expenses at the time of separation	15,900		
Less: Net revenue of C as below	480		
	15,420	5,140	10,280
Manufacturing Expense absorbed directly	8,000	16,500	14,500
Total cost	19,640	36,280	55,920
Inventory at end	8,500	6,500	15,000
Cost of sales	11,140	29,780	40,920
PROFIT OR LOSS	860	*5,780	*4,920
Less: Selling Expenses	1,200	2,400	3,600
NET LOSS	*340	*8,180	*8,520

COST AND MANAGEMENT

Statement of Net Revenue for Production of Product C

Gross Sales of C		1,200
Mfg. Expenses absorbed directly by C	600	
Selling expenses distributed to C	120	720
	<hr/>	<hr/>
Net revenue of C		480
		<hr/>

Comments on Problem No. 3

The candidates who attempted this question seemed to have little difficulty. The form of the statements presented was not too good, but the figures were quite simple to assemble. It is probable that the additional time required by candidates in Question No. 1 made it impossible for them to do justice to this problem as the average mark for all papers examined in problem No. 3 was only 9 out of a possible 15.

COST AND MANAGEMENT

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